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UNCLAS SECTION 01 OF 02 LAGOS 000103

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SUBJECT: ELECTIONS 2003: THE PROSPECTIVE ECONOMY AND THE PRICE OF POLITICS

¶1. Summary. On November 19 some forty corporate executives representing a broad cross-section of the non-oil sector met at the Lagos Business School to discuss the potential economic impact of the 2003 general elections. During the session led by Professor Pat Utomi, many executives expressed concern about the uncertainty associated with the upcoming general elections and their likely impact on the investment climate. Most of the executives fear that fiscal indiscipline will worsen as the spring elections approach, which will fuel inflation, raise interest rates, and depreciate the naira; most participants disclosed that their firms are consequently postponing major investments until after the elections. Alternative economic thinking, predicated on the desirability of priming the pump, nevertheless posits a more positive outcome of an expansion in government spending in the run up to the spring elections. End summary.

¶2. During the program at the business school, the consensus was aired that the biggest impediment to private sector investment in Nigeria is political uncertainty. Utomi contends, for example, that the government's process for implementing economic policy has been poorly coordinated and characterized by mixed signals, with long-term objectives often being sacrificed for short-term political gains. Many business executives echoed this opinion and faulted the government for its frequent and sudden changes in both policy and its implementation, making long-term investment decisions difficult. An example is President Obasanjo's recent declaration that oil producers should end gas flaring by the end of 2004 instead of by 2008 as envisaged earlier. According to Utomi, the business executives he has talked to all expect greater uncertainty as the elections approach and are, therefore postponing major investments.

¶3. Many executives also fear that the government may go on a "spending spree" during the next five months to secure political support. Here, we use the word government inclusively to cover all branches and all tiers of government. In general, the National Assembly has been far more inclined to be profligate than the Presidency. The latter's attempt throughout much of 2002 to check the legislature's propensity for spending resulted in a stalemate between these two branches of government. But even without executive-legislative agreement on a budget, federal funds can still be expended in an undisciplined fashion. The President can disburse up to fifty percent of the expected annual recurrent budget revenues of any fiscal year without National Assembly approval. Excessive non-discretionary and discretionary spending by the federal government accounts for continuing deficit spending. Reflecting this fact, Central Bank data on extensions of credit to the economy, in particular to government, show that the level in 2002 was far above the target figures established late 2001. Nigeria's federal structure compounds the problem. The fiscal authorities of the state and local governments have been irresponsible in the past three years. Having recklessly expended borrowed funds, the state and local governments have spent their allotments from the proceeds of the Federation Account in an equally cavalier fashion. That account is funded largely by oil export proceeds and is apportioned according to a 54.68; 24.72; 20.60 ratio. The federal fiscal authorities can do little to influence such spending by the states and local governments, even when it destabilizes the economy. Consequently and unsurprisingly, many of the executives at Lagos Business School forum said they expect excessive spending will continue even well after the general elections, as the victorious politicians will want to reward faithful supporters.

¶4. According to Utomi, the problem with such a likely expansionary fiscal policy is that it will fail to take account of the absorptive capacity of the economy. Since the infrastructure cannot absorb a massive infusion of capital effectively, few if any of the funds that will be disbursed will translate into meaningful economic activity. The funds that will be disbursed to procure votes, he said, will typically be channeled into the hands of a select few people who will spend most of the windfall on imported goods or exchange it for hard currency to be banked or spent abroad. Should the foreign exchange market be flooded with naira,

Nigeria's reserves will dwindle since the Central Bank will be under pressure to control the naira's depreciation. Utomi asserted that even with regard to legitimate government contracts, eighty kobos of every naira (100 kobos to a naira) flow into the foreign exchange market in search of hard currency for capital expenditures. Regardless of where the funds will go, whether for legtimate expenditures or procurement of votes, all the executives at the forum expect that government-induced excess liquidity will generate economic instability in the form higher prices for domestic or foreign goods and services.

¶5. Comment. Alternative economic thinking may justify the government measures mentioned above. Although conventional wisdom argues against a sharp and sustained expansion of credit to the government, it is conceivable that, since government spending is an engine of growth, we might see a pick up in economic activity before April based on higher government spending in the run up to the elections. While some private sector firms may not want to invest in a period of uncertainty, the government is a large client of other firms. Thus many firms may be caught in a bind; while political uncertainty may make them bearish, the chance of landing government contracts may overcome their skittishness in instances. Thus, if the GON can "turn on" spending during the first half of the year and then turn it off during the second half, the stimulus of the first six months might not greatly compound actual economic disequilibria. While such an outcome might be unlikely, GON strategists may be trying to do this. Even if it is improbable that they might succeed--because the "on/off" switch cannot be made to work instantaneously--there is nonetheless an off chance that they might achieve success if spending were to fund productive activity and enlarge Nigeria's absorptive capacity for investable funds. Of course, should such a strategy fail, the result would be even more destabilizing to private sector firms and individuals than if the GON had opted for an orthodox strategy. End comment.

¶6. Utomi asserted that years of military rule in Nigeria left a legacy of fractured institutions to the civilian government that is a cause of today's fiscal indiscipline. In the absence of a well-ordered, functional federal executive-legislative decision making apparatus that ensures stability and predictability, policy is easily reversed (and re-reversed) to suit political whims. In this regard, Utomi singled out the National Assembly for its lack of appreciation for sound economic policy. To make his point, Utomi said he had asked a well-known Senator recently whether "the Assembly was concerned about the health of the economy before next year's elections." The Senator replied: "Let me assure you, no one in the Assembly understands the economy and no one cares." Utomi went on that it is not surprising then that the Assembly tends to be "flexible" with legislation and that it often changes course when politically expedient.

¶7. Comment. Utomi is influential in certain circles, but his is only one voice. Politicking will fuel the economy in the first quarter, perhaps well into the second, even if oil prices begin to drop. While private sector firms may be restraining investment in front of elections, doing so is a rational decision given the uncertainty that elections imply. Once elections are over and the country's direction is clearer, these firms likely will begin to invest again. However, Nigeria's economic fundamentals are not strong and could weaken by mid-year as expenditures rise at all levels of government in front of general elections, possibly causing higher inflation and interest rates, as well as instability in the foreign exchange market. This would be bad news for most Nigerians whose real per capita income will probably have declined in 2002.

¶8. Although the various tiers of government have been incapable or unwilling to implement sound fiscal policy, the private sector too has failed to promote its interests effectively. Businesses have compiled long litanies of complaints against the government, but they have done little to ensure that specific solutions are implemented. Lacking entrepreneurial spirit, many private sector firms hold out for government subsidies or other incentives (understandable given the policy environment) rather than show initiative, which results in serious inertia. Many businesspeople are engaged in rent-seeking activity, benefit from their access to politicians and consequent ability to influence the policy environment and, ultimately, are not particularly interested in holding political leaders accountable for their actions.